

Message Text

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PAGE 01 EC BRU 05626 01 OF 02 231844Z

51

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FM USMISSION EC BRUSSELS

TO SECSTATE WASHDC 9116

INFO ALL EC CAPITALS 805

AMEMBASSY BERN

AMEMBASSY OSLO

AMEMBASSY STOCKHOLM

AMEMBASSY VIENNA

C O N F I D E N T I A L SECTION 1 OF 2 EC BRUSSELS 05626

E.O. 11652: ADS DECLASS JAN 1, 1978

TAGS: EFIN, EEC

SUBJECT: PROPOSED CHANGES IN OPERATIONS OF THE SNAKE

REFS: A. BERN 2563, B. EC BRUSSELS 5471, C. EC BRUSSELS 5415,
D. EC BRUSSELS 4623

1. SUMMARY. THE CENTRAL BANK GOVERNORS HAVE PROPOSED CHANGING THE SETTLEMENT PROCEDURES OF THE SNAKE AND EXTENDING ITS CREDIT PERIOD. THE GOVERNORS ARE ALSO SEEKING CLOSER COOPERATION WITH THE US IN COORDINATING INTERVENTIONS AGAINST THE DOLLAR. THE GOVERNORS REJECTED ESTABLISHING INTERVENTION ZONES AGAINST THE DOLLAR AND CHANGING THE SNAKE'S INTERVENTION RULES. END SUMMARY

2. THE EC CENTRAL BANK GOVERNORS CONSIDERED THE SEVERAL CHANGES TO THE SNAKE'S OPERATIONS WHICH FRANCE HAD PROPOSED. (SEE REF D.) THE GOVERNORS AND THE FINANCE MINISTER OF THE EC SNAKE COUNTRIES DISCUSSED THESE PROPOSALS BEFORE THE JUNE
CONFIDENTIAL

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PAGE 02 EC BRU 05626 01 OF 02 231844Z

16 FINANCE COUNCIL MEETING. THIS MESSAGE SUMMARIZES THE

CONCLUSIONS OF THIS DISCUSSION.

3. CHANGING THE INTERVENTION RULES: FRANCE PROPOSED SYMMETRICAL INTERVENTIONS IN DOLLARS BY CENTRAL BANKS WHOSE CURRENCIES WERE CLOSE TO THE UPPER AND LOWER LIMITS OF THE MARGIN. THIS WOULD SHARE THE BURDEN OF SUPPORT OPERATIONS TO KEEP CURRENCIES WITHIN THE MARGIN. THE FRENCH SUGGESTION OF INTERVENTIONS IN DOLLARS WOULD NOT REPLACE THE BASLE AGREEMENT WHICH REQUIRES INTERVENTIONS IN NATIONAL CURRENCIES WHEN A CURRENCY REACHES THE MARGIN.

4. THE GOVERNORS NOTED IN THEIR REPORT TO THE COUNCIL THAT IT WAS ALREADY POSSIBLE TO INTERVENE IN DOLLARS WITHIN THE MARGINS AND SUCH INTERVENTIONS HAVE FREQUENTLY OCCURRED IN THE PAST. THE CENTRAL BANKS OF STRONGER CURRENCIES CAN PURCHASE DOLLARS WHEN CENTRAL BANKS OF WEAKER CURRENCIES ARE SELLING DOLLARS. THIS HELPS TO RESTRAIN DIVERGENT EXCHANGE RATE MOVEMENTS. THE GOVERNORS CONCLUDED THAT NO MECHANICAL RULES SHOULD BE APPLIED AND INTERVENTIONS SHOULD PROCEED PRAGMATICALLY, ACCORDING TO MARKET CONDITIONS. THE EC CENTRAL BANKERS' COMMITTEE, NEVERTHELESS, AGREED TO STUDY RULES FOR AUTOMATIC INTERVENTIONS WHICH THE FRENCH PROPOSED.

5. INTERVENTION ZONES AGAINST THE DOLLAR: FRANCE PROPOSED RESUMING A POLICY OF COORDINATED INTERVENTION AGAINST THE DOLLAR. THE EC CENTRAL BANKS HAD ALREADY UNDERTAKEN ON AN EXPERIMENTAL BASIS INTERVENTIONS IN DOLLARS TO SMOOTH OUT DAILY FLUCTUATIONS IN THE DOLLAR RATE. THESE INTERVENTIONS ARE NOT DESIGNED TO RESIST SIGNIFICANT UNDERLYING TRENDS. FRANCE PROPOSED THAT THE DAILY MARGINS FOR DOLLAR FLUCTUATIONS SHOULD BE CUT IN HALF IN ORDER TO ESTABLISH BETTER CONTROL OVER THE FOREIGN EXCHANGE MARKET. THE DAILY MARGIN MIGHT ALSO BE MADE FLEXIBLE SO AS TO BETTER CHECK UNDESIRABLE MOVEMENTS IN THE DOLLAR RATE.

6. THE GOVERNORS' REPORT STATED THAT THIS SMOOTHING OUT OPERATION WOULD NOT HOLD THE DOLLAR AT A PREDETERMINED LEVEL. IN ADDITION, IT WAS BEYOND THE POWER OF THE EC TO DEFEND A GIVEN DOLLAR RATE BECAUSE THIS RATE WAS DETERMINED BY WORLDWIDE DEMAND FOR DOLLARS AND BY US ECONOMIC AND CONFIDENTIAL

CONFIDENTIAL

PAGE 03 EC BRU 05626 01 OF 02 231844Z

MONETARY POLICIES. FIXING THE DOLLAR RATE WOULD REQUIRE ACTIVE US ASSISTANCE TO WHICH THE US IS CURRENTLY NOT LIKELY TO AGREE. THE GOVERNORS ADDED THAT A PREDETERMINED DOLLAR RATE WOULD AMOUNT TO A DE FACTO RETURN TO THE DOLLAR STANDARD WHICH PREVIOUSLY HAD ADVERSE EFFECTS ON THE MEMBER STATES' DOMESTIC ECONOMIC POLICIES. THE LARGE OVERHAND OF DOLLARS AND THE VOLATILITY OF FUNDS IN THE EURO-MARKET WOULD MAKE IT IMPOSSIBLE TO DEFEND THE DOLLAR EVEN FOR A SHORT PERIOD. THE

GOVERNORS CONSEQUENTLY REJECTED A RETURN TO MANDATORY SUPPORT FOR THE DOLLAR. HOWEVER, THEY TOOK NOTE OF THE ERRATIC MOVEMENT OF THE DOLLAR IN RECENT WEEKS AND PROPOSED THAT CENTRAL BANKS SHOULD COORDINATE MORE CLOSELY THEIR EFFORTS TO SMOOTH OUT DOLLAR FLUCTUATIONS. COMMISSION OFFICIALS SAY THE EC PLANS TO SEEK CLOSER COOPERATION WITH US AUTHORITIES. THE EC PLANS TO RAISE AT THE NEXT BIS MEETING OF G-10 CENTRAL BANKERS WAYS TO STRENGTHEN THE CURRENT SMOOTHING OUT OPERATION AGAINST THE DOLLAR.

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PAGE 01 EC BRU 05626 02 OF 02 231842Z

51

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C O N F I D E N T I A L SECTION 2 OF 2 EC BRUSSELS 05626

7. EXTENSION OF VERY SHORT TERM CREDIT PERIOD: AT THE REQUEST OF THE DEBTOR COUNTRY, THE NORMAL VERY SHORT TERM CREDIT MAY BE AUTOMATICALLY EXTENDED FOR A THREE MONTH PERIOD. THE AMOUNT OUTSTANDING WILL BE LIMITED TO THE DEBTOR'S QUOTA UNDER THE EC SHORT-TERM CREDIT FACILITY. EC COUNTRIES HAVE THE FOLLOWING QUOTAS IN MILLIONS OF UNITS OF ACCOUNTS (U.A. EQUALS \$1.2): FRG, 600; FRANCE, 600; UK, 600; ITALY, 400; BELGIUM, 200; NETHERLANDS, 200; DENMARK, 90; AND IRELAND, 35. THIS LIMIT IS TO PREVENT A COUNTRY FROM BECOMING HEAVILY INDEBTED. THE GOVERNORS ALSO DECIDED THAT THERE SHOULD BE A

TIME LIMIT TO THE CONTINUING USE OF THIS AUTOMATIC EXTENSION. THEY WANTED TO AVOID SEMIPERMANENT USE OF THIS CREDIT AND DECIDED THAT A DEBTOR COUNTRY SHOULD ONLY USE THIS CREDIT UP TO A MAXIMUM OF CONSECUTIVE SIX MONTHS. THERE WILL CONTINUE TO BE NO LIMIT, HOWEVER, ON FINANCING OF INTERVENTIONS WHICH ARE FOR A PERIOD OF 30 DAYS AFTER THE MONTH IN WHICH THE INTERVENTIONS TAKE PLACE.

8. SETTLEMENT PROCEDURES: SNAKE PROCEDURES CURRENTLY REQUIRE
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PAGE 02 EC BRU 05626 02 OF 02 231842Z

THAT CREDITS FOR INTERVENTION OPERATIONS SHOULD BE SETTLED IN PROPORTION TO THE DEBTOR COUNTRY'S HOLDINGS OF GOLD-BASED ASSETS (I.E., GOLD, IMF POSITION AND SDRS) AND FOREIGN CURRENCIES. THIS PROCEDURE CREATES DIFFICULTIES BECAUSE GOLD IS NOT USED FOR SETTLEMENT PURPOSES. THE GOVERNORS DECIDED THAT GOLD SHOULD BE EXCLUDED FROM THE CALCULATION OF THE DEBTOR COUNTRY'S RESERVES. A DEBTOR WOULD SETTLE WITH ITS IMF POSITION AND SDRS ON ONE HAND AND WITH FOREIGN EXCHANGE ON THE OTHER. THUS, GOLD WOULD BE EXCLUDED FROM THE CALCULATION OF RESERVES AND AS A MEANS OF SETTLEMENT. GOLD, HOWEVER, COULD BE USED ON A VOLUNTARY BASIS AND ON MUTUALLY AGREED CONDITIONS TO REPLACE ANY OTHER SETTLEMENT INSTRUMENT.

9. COMMENT. THESE PROPOSED CHANGES IN THE SNAKE'S OPERATIONS WERE NOT FORMALLY ADOPTED BY THE FINANCE COUNCIL ON JUNE 16. IN FACT, THE CENTRAL BANK GOVERNORS USUALLY HANDLE THE DETAILS OF SNAKE OPERATIONS AND IT IS NOT CLEAR WHAT AUTHORITY THE COUNCIL HAS IN THIS AREA. THE EC COMMISSION, HOWEVER, PLANS TO SUBMIT A DRAFT RESOLUTION TO THE COUNCIL ON JULY 10. IF APPROVED, THIS RESOLUTION WOULD OFFICIALLY INCORPORATE THE GOVERNORS' PROPOSED CHANGES INTO THE SNAKE'S OPERATIONS.
END COMMENT. GREENWALD

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